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Supreme Court of the United States

OCTOBER TERM, 1966

No. 1084

COLUMBIA BANK FOR COOPERATIVES, PETITIONER,

versus

H. KENNETH LEE, TRUSTEE IN BANKRUPTCY, RESPONDENT

In the Matter of: FARMERS FEDERATION COOPERATIVE, INC., BANKRUPT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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COLUMBIA BANK FOR COOPERATIVES, PETITIONER,

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H. KENNETH LEE, TRUSTEE IN BANKRUPTCY, RESPONDENT

In the Matter of: FARMERS FEDERATION COOPERATIVE, INC., BANKRUPT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioner prays that a writ of *certiorari* issue to review the decision and judgment of the United States Court of Appeals for the Fourth Circuit, dated and entered in this case October 4, 1966 and as expanded by Memorandum Order denying rehearing dated and entered November 23, 1966.

OPINION BELOW

The opinion of the District Court is reported as, In the Matter of FARMERS FEDERATION COOPERATIVE, INC., BANKRUPT, 243 F. Supp. 650 (DCNC 1965). The opinion of the Court of Appeals, including the Memorandum Order denying a rehearing, is reported as *Columbia Bank for Cooperatives v. Lee,* 368 F. (2d) 934 (4th Cir. 1966).

JURISDICTION

The judgment of the Court of Appeals was dated and entered on October 4, 1966. Petition for Rehearing was denied on November 23, 1966 by Memorandum Order Expanding the Original Opinion. The jurisdiction of this Court is invoked under provisions of 28 U.S.C., Section 1254(1).

QUESTIONS PRESENTED

1. Should a court of bankruptcy disrupt a statutorily prescribed system of capitalizing and administering farm credit facilities by requiring a district bank for cooperatives (an instrumentality of that system and of the federal government) to accept in satisfaction of a valid debt owed to it by a borrowing cooperative, the debt being secured in a good faith transaction by valuable property, stock of the bank owned by the defaulting cooperative instead of allowing the bank for cooperatives to realize on the security taken by it for the loan, thus undermining the bank's capitalization and prejudicing non-defaulting agricultural cooperative borrowers?

2. Where the Farm Credit Act provides that an agricultural cooperative which borrows from a bank for cooperatives must also purchase certain stock in that bank as a means of capitalizing the bank through the commitments of those using its facilities, further providing that such stock may be redeemed by the bank only in the order of its issuance, is a court of bankruptcy authorized to re-

quire the bank to redeem such stock of a defaulting borrower out of order and contrary to the statute?

3. Is a court of bankruptcy entitled to change a stockholder-corporation relationship into a debtor-creditor relationship where the debtor had no such right?

4. May a court of bankruptcy assert the non-statutory doctrine of "marshalling of assets" for the benefit of general creditors and against a secured creditor, solely because, by statute, the secured creditor has an "additional" lien upon its stock purchased and held by the bankrupt (as required by law) when the effect of the doctrine will be (i) to deprive the secured creditor of the valuable right of a reasonably anticipated realization upon its security, (ii) to weaken the capital structure of the secured creditor, and (iii) to favor without authority and solely on the grounds of convenience for them, general creditors over the secured creditor?

5. May the court of bankruptcy vest a trustee with power to credit value of stock in a bank for cooperatives owned by a bankrupt cooperative against the bank's valid claim when the bankrupt had no right to claim such credit, thereby abolishing the rule of this Court that a trustee succeeds only to such rights as his bankrupt possessed and is subject to all claims and defenses which might have been asserted against his bankrupt?

6. Does § 57(h) of the Bankruptcy Act, establishing a procedure for secured creditors so desiring to participate generally when the security is inadequate, vest the court of bankruptcy with power to alter relationships established by contract and by law between a secured creditor and the debtor, thus permitting the Court to force the creditor to submit for valuation as its security not only the property taken specifically as security for the debt through instruments drafted and recorded for that purpose and relied upon as such by the creditor but also an "additional",

secondary collateral relationship, in the process forcing the creditor to accept as repayment the secondary collateral even though adequate funds to pay the claim were held by the trustee in bankruptcy as a result of a consent sale of properties upon which secured creditor had a first lien?

STATUTORY PROVISIONS AND REGULATIONS INVOLVED

The statutory provisions and regulations involved are: The Farm Credit Act of 1933, as amended, Title 12 U.S.C. Section 1134, *et seq.;* Regulations issued by Farm Credit Administration, 12 CFR 670.142; 12 CFR 670.153; 12 CFR 670.162; 12 CFR 670.164; 12 CFR 670.165; 12 CFR 670.-165(a); Sections 57(h), 68 of The Bankruptcy Act, as amended (11 U.S.C. 93(h), 108(a)). The pertinent parts thereof are printed in the Appendix, *infra,* pp. 44-50.

STATEMENT OF CASE

Jurisdiction of the case was properly in the District Court, this matter arising under The Bankruptcy Act (11 U.S.C. Section 1, *et seq.*).

Petitioner, the Columbia Bank for Cooperatives, is one of 13 banks for cooperatives whose function is to make loans to eligible farmer cooperative associations that are engaged in marketing farm products, purchasing farm supplies, or rendering farm business services. It is a Federal instrumentality (48 Stat. 267, as amended, 12 U.S.C. 1138(c)), chartered by the Governor of the Farm Credit Administration pursuant to the Farm Credit Act of 1933 (48 Stat. 257, as amended, 12 U.S.C. 1134, *et seq.*). Petitioner received its charter in 1933 and serves the Third Farm Credit District (composed of North Carolina, South Carolina, Georgia, and Florida), one of the 12 farm credit districts into which the United States is divided (50 Stat. 704, as amended, 12 U.S.C. 640(a)).

Like all banks for cooperatives, petitioner operates under the general supervision of the Farm Credit Administration, an independent agency of the Federal Government (67 Stat. 390, 12 U.S.C. 636(b)). Within certain statutory limitations, its loans are made subject to such terms and conditions as may be prescribed by the Farm Credit Administration (48 Stat. 264, as amended, 12 U.S.C. 1134 (c)). A bank may and in some cases must require adequate real estate security when a loan is closed. The funds with which to make loans are largely obtained by the banks for cooperatives selling their collateral trust debentures to the investing public (48 Stat. 263, as amended, 12 U.S.C. 1134 (m), *infra*, p. 46.)

The banks for cooperatives were originally capitalized in 1933 by the United States. While the original enactment required the borrowers to purchase capital stock of the bank in connection with each loan, that stock, until 1956, was retirable when the loans were repaid. At the end of 1955, the borrowers owned only about 12 percent of the capital stock of the banks.

Effective January 1, 1956, by the Farm Credit Act of 1955 (69 Stat. 655), Congress amended the Farm Credit Act of 1933 to provide for the banks for cooperatives to be operated on a cooperative basis and for the Government capital to be retired from each bank as the farmer cooperative associations that borrow from the bank gradually acquire complete ownership of the bank. Today, the capital stock of the banks owned by the borrowers has increased to about 73 percent overall; four of the banks have retired all of their Government capital and the other nine are expected to do so within about five years. This gain in borrower capital is largely because it no longer is retirable when a loan is repaid, but may be retired only as will be described later. There are now some 3,000 farmer cooperative associations, with an aggregate membership of well

over a million farmer producers, that borrow from the banks for cooperatives and have provided them with capital. Several of such borrowing associations have holdings in the banks amounting to over a million dollars each.

Since 1956, in addition to some of its old stock that was not retired or converted, each bank for cooperatives has had three new classes of stock (A, B, and C). Class A is or was held by the United States; class B may be held by investors generally and was also issued in exchange for old stock (pre-1956) in the bank held by former borrowers; and class C is issued to current borrowers. The amount of class A (Government) stock required to be retired each year is the equivalent of class C stock issued to borrowers for that year. (12 U.S.C. 1134d (a) (1), *infra,* p. 44.)

A borrower acquires class C stock in a bank for cooperatives in two ways, by purchase and as patronage refunds. Each year a borrower is required to purchase class C stock in the lending bank in an amount equal to from 10 to 25 percent of the amount of interest payable on its loan. (12 U.S. C. 1134d (3), *infra,* p. 44.) The exact percentage is specified by the board of directors of the bank with the approval of the Farm Credit Administration. Each year, too, a bank for cooperatives must apply its earnings as specified in the law. Any earnings not required to be applied otherwise are distributed to the borrowers as patronage refunds in the form of class C stock. (12 U.S.C. 11341 (a), *infra,* p. 45.) This is done in proportion to the amount of interest earned on each loan. As to that portion of the annual earnings required to be retained in the surplus account of the bank, it is allocated to the borrowers, also in proportion to the amount of interest earned on each loan. When the surplus account exceeds a certain level, the excess, if no longer deemed necessary for the sound operation of the bank, may be distributed to the borrower to whom it was allocated in the form of class C stock. (12

U.S.C. 1134l (a), *infra,* p. 45.) In the present case, the bankrupt borrower holds allocated surplus and capital stock (class B and C) of the petitioner which was acquired in the manner indicated.

After the Government capital is retired from a bank for cooperatives, there is provision for the class C stock held by the borrowers to be revolved, *i. e.,* retired and the proceeds paid to the holders in money, but the oldest outstanding class C stock must be retired first. Further, class C stock that was issued for a fiscal year period may not be so revolved until all class B stock that was issued during or prior to that fiscal year has been called for retirement. (12 U.S.C. 1134d (a) (3), *infra,* p. 44.) This is the basic plan for retiring class C stock, subject to the exceptions next to be noted.

As provided in the law and in its bylaws, a bank for cooperatives has a first lien on all stock and allocated surplus in the bank owned by each cooperative association as additional collateral for any indebtedness of such association to the bank. (12 U.S.C. 1134d (c), *infra,* p. 44.) While there is further provision that such capital stock and allocated surplus may be retired and applied on the indebtedness in the event of default by the borrower, or may be retired and the proceeds paid to the borrower in the event of its liquidation or dissolution, any such retirements are subject to regulations of the Farm Credit Administration (12 CFR 670.153, 12 CFR 670.165 (a), *infra,* pp. 47, 48, 49) are in the discretion of the bank for cooperatives in the light of its overall objectives.

In the present case the controversy arises from a bankruptcy proceeding in the Court of first instance. On February 15, 1963, Farmers Federation Cooperative, Inc. (hereinafter referred to as Bankrupt), a corporate cooperative association of farmers organized and existing under the laws of the State of North Carolina, was adjudged a

bankrupt pursuant to order of the United States District Court for the Western District of North Carolina (Asheville Division). At the time of this adjudication, the Columbia Bank for Cooperatives, a corporation organized under the laws of the United States of America, operating on a cooperative basis, with its principal place of business at Columbia, South Carolina (hereinafter referred to as Petitioner), by way of Proof of Secured Claim asserted that the Bankrupt was indebted to it for loans advanced in the principal sum of $146,371.68, plus interest accrued through February 14, 1963, in the sum of $13,153.47, plus interest accruing thereafter, plus $2,630.70 for the purchase of class C stock of the Petitioner pursuant to the requirements of the Farm Credit Act of 1955 (12 U.S.C. 1134d (3) *infra,* p. 44), and regulations issued pursuant thereto. (12 CFR 670.142), *infra,* p. 47.)

Petitioner further asserted this indebtedness was evidenced by promissory notes, and was secured by various mortgage (deeds of trust) on lands, buildings, fixtures and machinery of the Bankrupt located in various counties in Western North Carolina. After reciting this security, the Proof also recited that, by the provisions of Section 1134d (c) of Title 12 U.S.C. and 12 CFR 670.164, *infra,* p. 48), Petitioner had a first lien on all stock in the Bank owned by Federation and all interest of Federation in the allocated surplus and reserves of Petitioner. At the time of adjudication, Bankrupt held 458 shares of class B stock of the Petitioner, which had a par value of $45,800.00, and 542.7518 shares of class C stock of the Bank, which had a par value of $54,275.18. Of the accumulated surplus of Petitioner, $13,045.64 has been allocated on its books to Bankrupt.

Thereafter, with consent of Petitioner, various parcels of real property on which it held deeds of trust were sold;

and by order of the Referee dated July 17, 1963, H. Kenneth Lee, the duly appointed Trustee in Bankruptcy, hereinafter referred to as Respondent, deposited the proceeds of the sale ($167,000.00) in a special account to be held pending further orders of the Court.

Thereafter, Respondent, Trustee in Bankruptcy, filed an Answer to the Petitioner's Proof of Secured Claim admitting the indebtedness and the security therefor but by Further Answer and Defense took the position that the fair book value of the class B and class C stock of the Petitioner held by Bankrupt was not less than par, and claimed that the alleged value of this stock and the surplus allocated to Bankrupt should be credited and offset against the secured claim of Petitioner. The Respondent Trustee also took the position that Petitioner was entitled only to the difference between the total value of both classes of stock (taken to be par value) and the surplus of Petitioner allocated to Bankrupt, on the one hand, and the amount of the debt of the Bankrupt on the other. The Respondent further prayed that the Petitioner be adjudged the owner of the stock and allocated surplus, that the remainder of the special account, which contained the proceeds of the sale of property as to which the Petitioner held deeds of trust, be released for distribution as part of the General Fund of the Bankrupt, and that Petitioner be ordered to release the remainder of Bankrupt's property from deeds of trust and mortgages held as security by Petitioner. The Respondent Trustee thus asked that a valuation of $113,120.82 be placed upon the stock of Petitioner owned by the Bankrupt and the surplus allocated to Bankrupt, as to which Petitioner had a statutory lien as additional security for debts owed to it by Bankrupt; and that Petitioner be required to accept a return of the stock and a reallocation of its reserve in satisfaction of the major part of Bankrupt's debt to it.

Subsequently, the Petitioner moved to dismiss the Answer and Further Defense of Respondent Trustee on the grounds that the Answer and Further Defense did not state a claim against Petitioner for which relief could be granted.

On October 19, 1964, attorney for Respondent Trustee wrote the treasurer for Cotton Producers Association, Atlanta, Georgia, a cooperative association, stating that the Respondent would be willing to entertain a proposition from The Cotton Producers Association concerning sale of the stock. On November 3, 1964, by letter an offer was made by The Cotton Producers Association to purchase the stock for $50,000.00. This offer was never rejected nor accepted. (This is the only evidence in the record bearing upon market value of the stock.)

The Matter came on for hearing before the Referee after which the Referee made findings of fact and conclusions of law and entered an order overruling the motion of Petitioner; directing Bankrupt to surrender its stock in Petitioner as a credit against the indebtedness at par value, together with all accrued or allocated surplus, and directing the parties to determine then the balance due after application of the credits, allowing the balance as a secured claim. (*infra,* pp. 40-44.)

Instead of dealing only with the preliminary questions of law which were raised by the motion to dismiss, the Referee thus proceeded at once to fix a value on the stock and allocated surplus, and determined that the claim of Petitioner should be paid partly in its own stock and partly from a portion of the proceeds of the sale of real estate, the full amount of which the latter was adequate to have paid the entire claim of Petitioner.

Petitioner excepted to the findings of fact, conclusions of law and order of the Referee and filed a petition for review by the District Court.

On review the District Court affirmed the action of the Referee (*infra,* pp. 35-40), and in doing so specifically relied upon the application of 11 U.S.C. Section 93(h), Section 57(h), of The Bankruptcy Act. (*Infra,* p. 37.)

Before appeal was heard before the Court below, Florida Citrus Canners Cooperative and Plymouth Citrus Products Cooperative, The Cotton Producers Association, and the other banks for cooperatives were allowed to file briefs *amicus curiae* in support of the Petitioner's position.

Upon appeal, the Court of Appeals, by its opinion dated October 4, 1966 (*infra,* pp. 25-33), affirmed the application of Section 57(h) of The Bankruptcy Act in this matter and also invoked the doctrine of "marshalling of assets", but remanded the matter for a hearing or other appropriate proceedings under 57(h) for the determination of value of the stock in question.

In its decision, the Court below rejected the contention that the statutory lien on the stock was a secondary and additional lien but on the contrary placed it in a superior position by requiring the value of the stock to be offset against the claim of Petitioner prior to resorting to funds resulting from sale of properties upon which Petitioner had a first lien. In invoking the doctrine of "marshalling of assets" the Court below treated the Petitioner, the only secured creditor, and general creditors alike, putting all in the same class. The opinion refers to the offer made by Cotton Producers Association (45 per centum of par value) and strongly indicates such is not the true value and that a sale at these figures would work a hardship on general creditors. Governed by such indications a Referee below could hardly find the value to be less than 45 per centum and in view of the decision would probably find the value to be

more than 45 per centum. Throughout the opinion, the Court of Appeals is influenced by its mistaken belief that Petitioner could dispose of the stock in question to other borrowers and that there would be no loss to Petitioner.

Petition for rehearing was filed submitting that the decision of the Court below remanding the matter to the District Court contained statements and reasoning indicating a misunderstanding of certain provisions of the Farm Credit Act and that proper construction of these provisions would call for a reversal of the Order of the District Court; and prayed that the Court below order the full amount of the Bankrupt's debt to Petitioner be paid from funds held by the Respondent Trustee as a result of sale of property which was the primary security for such debt. It was further submitted that the statements made by the Court of Appeals would have the effect of prejudicing any hearing had under Section 57(h) or any other appropriate proceedings under such section, would be influential and prejudicial in any future cases under similar situations and were not necessary in remanding the matter to be disposed of under Section 57(h).

By its Memorandum Order dated November 23, 1966 (*infra*, pp. 33-35), the Court below denied the Petition for rehearing but in order to avoid any possibility of misunderstanding of its statement "owners of Class C stock are entitled to annual 'patronage refunds' out of bank's net earnings . . .", it added to footnote 5 of the decision the following: "It is to be noted that patronage refunds are to be paid 'in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year'." However, the Court of Appeals did not adequately deal with (i) the injury to other borrowing cooperatives whose reasonable expectations are thwarted when the bankruptcy court forces redemption out of order;

(ii) the damage to the bank in terms of its ability to make adequate arrangements to secure loans; or (iii) the direct damage to the bank's capital structure when a debt is satisfied by retirement of its stock. The Court below also reiterated its feeling that a forced sale of the stock would be at a figure that a hearing under 57(h) may show to be a fraction of its real value, thus failing to eliminate the prejudicial aura placed upon a valuation hearing under 57(h).

REASONS FOR GRANTING THE WRIT

1. The decision herein involves a question of nationwide and continuing importance concerning the relationship of the Farm Credit Act to bankruptcy proceedings which has not been, but should be settled by this Court.

The Court below requires that the value of stock and allocated surplus in a bank for cooperatives owned by a bankrupt, on which bank has a statutory lien, be offset (applied) against a debt owed the bank before resorting to funds held by the Trustee in Bankruptcy as a result of sale of property which was the primary security for such debt and which funds are ample to pay the entire debt. The Farm Credit Act of 1933, as amended, provides that capital stock and allocated surplus, may, as additional security be retired and applied on the indebtedness of a borrower only in event of default by the borrower, or may be retired and the proceeds paid to the borrower in liquidation or dissolution. Any such retirement, however, by statute, is subject to regulations of the Farm Credit Administration and is entirely within the discretion of the bank for cooperatives in the light of its overall objectives. (12 CFR 670.165a, *infra*, p. 49.) Clearly, the purpose of this section is to give the bank for cooperatives a last resort. It is not applicable, and may not be invoked, where the bank is otherwise adequately secured as to the indebtedness. Petitioner challenges the power of the Court below to require such

retirement either directly or indirectly, particularly when the Petitioner, after due consideration, has deemed it not to its best overall interest to retire the capital stock and allocated surplus. Petitioner believes this to be beyond the province of the bankruptcy Court and infringes upon and conflicts with the provisions of the Farm Credit Act of 1933, as amended.

The basic plan of the 1955 amendment was to have the capital contributions made by the borrower remain in the system until all of the capital stock of the United States had been retired. (See House Report No. 863 accompanying H.R. 5168, *infra,* p. 50.)

The right of the banks, with approval of the Farm Credit Administration, to retire capital stock of borrowers prior to the retirement of government stock is purely a discretionary right and to be exercised only upon the determination by the banks and the Farm Credit Administration that such is in the best interest of the system and would not unduly affect the financial position of the bank.

Congress intended banks for cooperatives, with the approval of the Farm Credit Administration, to have exclusive and unreviewable power of discretion in determining when capital stock and allocated surplus in bank owned by a borrower could be retired and the jurisdiction of the banks, with the approval of the Farm Credit Administration, is exclusive and not subject to review.

2. **The decision herein is not in accordance with the applicable decisions of this Court and is contrary to Federal statutes.**

(a) The decision in the Court below is in direct conflict with, among others on the subject, the holding by this Court in *Bank of Marin v. England,* .... U. S. ...., 87 S. Ct. 274, 17 L. Ed. (2d) 197 (1966), that, a Trustee in bankruptcy succeeds only to such rights as the bankrupt pos-

sessed; and the Trustee is subject to all claims and defenses which might have been asserted against the bankrupt but for the filing of the petition.

The issue raised herein involves an important question of Federal substantive law and the Court below has so departed from the pronounced rule as to call for exercise of this Court's right of review.

Petitioner submits, that the position of creditors has not changed since Federation has been adjudged a bankrupt and at that time the Bankrupt had no right to demand redemption or retirement of its stock or allocated surplus in the Petitioner. Why should that right be enlarged after bankruptcy as the Court did below? The Bankruptcy Act "does not vest the Trustee with any better right or title to the bankrupt's property than belongs to the bankrupt or his creditors at the time when Trustee's title accrues", *Hewitt v. Berlin Machine Works,* 194 U. S. 296, 24 S. Ct. 690, 48 L. Ed. 986 (1904); *Hyman v. McLendon* (C. C. A. 4th, 1944), 140 F. (2d) 76, cert. den. (1944), 322 U. S. 739, 64 S. Ct. 1055.

Here, the Court below surrounds the Trustee with power to require the Petitioner to accept the value of its stock owned by the Bankrupt on a debt owed to the Petitioner, when the Bankrupt had no legal or moral right to do so prior to the filing of the petition.

(b). The decision below violates Section 68a of The Bankruptcy Act, Title 11 U.S.C., Section 108(a) (*infra,* p. ....), as it pertains to setoffs and counterclaims. Whether or not the Court admits to establishing a "creditor-debtor" relationship between a corporation and a stockholder, it has in this case. Section 108(a) requires that there be mutuality of debts before setoff can occur. The test of mutality under Section 68a of The Bankruptcy Act, Title 11 U.S.C. 108(a) requires that the claim be valid and enforceable at

the time of bankruptcy (*United States v. Luther* (C. A. 10th 1955), 225 F. (2d) 405).

The effect of the holding by the Court of Appeals in this case is necessarily that a "creditor-debtor" relationship exists between a stockholder and his corporation and that the corporation must credit the value of the stock before it proceeds against the stockholder pursuant to an admitted secured claim. Petitioner submits this is contrary to all rules of construction and contends such requires review by this Court. A stockholder, merely because of his ownership of stock in a corporation, is not a creditor of the corporation. (See: *Chold Corp. v. Commissioner of Internal Revenue*, 97 F. (2d) 22; *Bryan v. Welch*, 74 F. (2d) 964 (1935).) As pointed out above, the bank did have a first lien on the stock as "additional security". However, the bank having taken no action to enforce that lien, the relationship between it and its shareholder as represented by the stock remains the same. If such an offset, as required by the Court below, is allowed to stand the principle could be used as a defense in any claim for money where the same relationship exists. Stock represents capital and a corporation cannot be required to deplete its capital by application of the value of its stock against debts of the holder. The stock does not evidence a debt within the bankruptcy law and therefore, cannot be used as a setoff. The essential difference between a stockholder and a creditor is that the former intends to invest and take the risks involved, while the creditor seeks a definite obligation and expects to be paid in any event.

(c) The decision in the Court below is in direct conflict with the pronouncement by this Court in *Ethel Meyer v. United States*, 375 U. S. 233, 84 S. Ct. 318, 11 L. Ed. (2d) 293 (1963), in that, in applying the doctrine of "marshalling assets" this Court said, "It deals with the rights of all who have an interest in the property involved and is applied

only when it can be equitably fashioned as to all of the parties."

The thread of "equity" runs throughout the opinion below but in the instant question, the equities are not equal and in this situation, invocation of the doctrine of "marshalling assets" is completely inappropriate. The decision would require the Petitioner to first allow a credit on the indebtedness for the capital stock and allocated surplus owned by the Bankrupt borrower, before resorting to the proceeds of the real estate security, the amount of such credit to be determined by a hearing below to establish the value of the capital stock and allocated surplus. The Court below may have assumed that such capital stock and allocated surplus could be used again to meet the annual investment in capital stock required of other borrowers or for payment of patronage refunds in subsequent years. Such is not the case. All that the Petitioner presently could realize from the capital stock and allocated surplus is the amount at which it could be disposed of to a qualified buyer willing to purchase it as an independent investment. The purchase price would necessarily be influenced by the indefinite period before revolvement of the capital stock of Petitioner. If the amount required to be credited against the indebtedness for the capital stock and allocated surplus is greater than the Petitioner presently could realize thereon, that would be tantamount to disallowing the claim of the Petitioner for the amount of such difference, notwithstanding the proceeds of the real estate security held by Petitioner are adequate to pay the indebtedness in full.

It is not unfair, unjust, or inequitable that one creditor have a greater or even a more conveniently asserted right than another. A creditor who was able to provide himself fairly with security for his debt is not required by law to give up his security, even though he may have other security for the convenience of the creditors who do not

have security, or who have less adequate security. See: *Merrill v. National Bank of Jacksonville,* 173 U. S. 131, 138 (1899). There is no rule or doctrine which would force a Court of equity to require that a creditor having greater rights surrender all or a part of those rights in a bankruptcy proceeding, solely because this would be to the benefit of creditors having lesser rights. On the contrary, it is clear that, under The Bankruptcy Act, the rights of the creditor are to be respected to the extent possible. (See: *Consolidated Rock Co. v. DuBois,* 312 U. S. 510, 61 S. Ct. 675, 85 L. Ed. 975 (1940).) Moreover, the doctrine of "marshalling assets" simply does not apply to unsecured creditors seeking to require the secured creditor to surrender the security to the General Fund. (*The First National Bank of Boston v. Proctor,* 40 F. (2d) 841 (1st Cir. 1930).)

In the present case, the holding is in favor of creditors generally, none of whom were secured by either of the two funds involved, i.e., the allocated surplus and capital stock on the one hand, or the real estate security on the other hand. However, "[a]n unsecured creditor does not have equal standing with a secured creditor under the doctrine of marshalling assets. 19 EM. and Eng. Ency. 1284; 18 R.C.L. 458; 38 C.J. 1379, 1380; *Emmons v. Bradley,* 56 Me. 333, 338; *The Edith,* 94 U. S. 518, 24 L. Ed. 167"; *First National Bank of Boston v. Proctor,* 40 F. (2d) 841 (1st Cir. 1930).

The stock in question could not replace new stock issued pursuant to statute. Even if it could replace required stock, the sale of such as required stock would give those borrowers purchasing it a preference over those having been required to purchase recent new stock, since the old stock would be retired first. In fact, under the present requirement that an association purchase C stock in the amount of 10 percent of yearly interest on loans, it would

require interest in the amount of some $1,130,000.00 for the stock in question to be repurchased. Petitioner would have to sell the stock as the interest accrued. If projected to its conclusion, Petitioner by reselling (re-issuing) this stock, would be greatly and improperly delayed in "revolving" the earlier stock, and could by such a course avoid the legitimate realization by holders of the earlier stock of an expected economic benefit. By statute, retirement must be by sequence. Thus, the only way the Petitioner could sell (dispose of) the stock and at the same time implement the statutory policy of sequential retirement, would be to sell it to associations, merely for investment purposes and not as a substitute for stock purchases required by statute. The attractiveness of this stock as an investment is limited. The length of time which must elapse before class C stock can be redeemed in cash is dependent upon Petitioner's future volume of business, its loss experience on loans, the relation between the cost of borrowed funds and the Petitioner's loan rates, the amount of net savings over a future period of many years' duration and other factors, none of which are presently determinable. The Petitioner herein has not yet retired all its class A stock now outstanding. Any purchaser would have to compute value with these conditions in mind. Furthermore, the Petitioner should not be placed in the position of having to peddle its stock as investment paper; borrowing associations might feel they were obligated to purchase such to obtain or retain a favorable position with Petitioner.

To allow the ruling below to stand would invest the Bankrupt and its creditors with a clear preference and advantage over, and to the severe prejudice and detriment of, the Petitioner, holders of debentures on which Petitioner is liable, and other cooperative associations, borrowing from Petitioner in reliance upon the statutory procedure. If equity is to be invoked in this case, it should be

invoked on behalf of farmer cooperatives who have planned their refunds to members on the basis of the reasonably sure expectancy of proceeds accruing to the cooperatives by reason of redemption of stock by the Petitioner. On the other hand, Bankrupt and its unsecured creditors would enjoy, under the ruling of the Court below, a windfall. The ruling of the Court below will, in fact, place defaulting or liquidating borrower-cooperatives in a more advantageous position than those borrower-cooperatives not in default or liquidation.

(d) The decision in the Court below is in conflict with the ruling by this Court in *U. S. National Bank in Johnstown, et al. v. Chase National Bank of New York City,* 67 S. Ct. 1041; 331 U. S. 28 (1947), that Section 57(h) permits the secured creditor to receive dividends along with the general creditors only on the balance remaining after the value of the security has been determined and deducted from the claim. The Court below treated 57(h) as authority for determining the value of all secured assets even though it had been determined by the sale of property under deeds of trust held by Petitioner that there were ample funds to pay the entire claim and Petitioner never sought to receive dividends as a general or unsecured creditor.

This represents a complete misconstruction of Section 57(h). That section, if applicable, was satisfied by the Court-approved sale of the lands upon which bank held mortgages. Bank did not, and had no need to, seek to share in the general fund. The use of Section 57(h) as a weapon to deprive bank of proceeds of the security to which it was entitled, and which satisfied the indebtedness to it of the bankrupt, was erroneous.

CONCLUSION

For the foregoing reasons, this Court should grant this Petition for a Writ of Certiorari, should reverse the decision of the Court below and order the Court of Appeals to remand the case to the District Court for payment of Petitioner's secured claim from funds held by the Trustee in Bankruptcy.

Respectfully submitted,

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Attorneys for Petitioner.

Petitioner is a bank for cooperatives chartered by the Governor of Farm Credit Administration. A majority of the bank's stock is now privately owned; the remainder is owned by the United States. In light of the court of appeals' remand "to give the parties a full and fair opportunity to establish the actual value of the stock", the Solicitor General does not believe that this case, in its present posture, calls for review by this Court. However, inasmuch as the interests of private stockholders are also involved, the filing of the above petition has been authorized.

THURGOOD MARSHALL,
Solicitor General.

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DECISION OF COURT OF APPEALS

(Argued April 6, 1966. Decided October 4, 1966.)

Before SOBELOFF and BOREMAN, Circuit Judges, and BARKSDALE, District Judge.

Edwin P. Gardner (John F. Shuford and Robert A. Hope on brief) for Appellant, Thomas A. Uzzell, Jr., (Frank M. Parker, Uzzell and DuMont, and Parker, McGuire & Baley on brief) for Appellee, and Francis Shackelford (Alston, Miller & Gaines on brief) for Cotton Producers Association as Amicus Curiae.

Sobeloff, Circuit Judge:

This is a case of first impression involving the relation of the Farm Credit Act to bankruptcy proceedings.

Farmers Federation Cooperative, Inc. (hereafter Federation) was adjudicated a bankrupt in February, 1963, and appellee H. Kenneth Lee was appointed trustee. Federation then owed approximately $162,000 to the Columbia Bank for Cooperatives (hereafter the bank), secured by mortgages and deeds of trusts on certain property of the bankrupt. By agreement of the trustee and the bank, some of this secured property was sold, and the proceeds—about $167,000—were deposited in a special account pending further order.

In addition to the mortgages and deeds of trust, the bank was also entitled by statute to a lien on certain stock issued by it to Federation pursuant to the Farm Credit Act, 12 U.S.C. §1134d(c) (1958). The referee in bankruptcy found that in the hands of the bank this lien was worth the full par value of the stock, $113,120.82, but that because of its limited marketability, the amount realizable in a sale by the trustee would be much less. Consequently, the referee ordered Federation to surrender the stock to the bank for a credit against Federation's indebtedness calculated on the basis of the value of the stock to the bank. The District Court affirmed the referee's order and dismissed the bank's petition for review.

I

In order to understand the issues, it is necessary first to outline the structure and operation of the Farm Credit system, and the relationships established thereunder between the bank and Federation. The bank and Federation are both part of the farm credit scheme established by Congress. To aid in the financing of cooperatives and farmer's cooperative federations, twelve regional and one central bank were created in 1933, capitalized largely by government funds and partly by sale of stock to borrowing cooperatives. In 1955, Congress altered this structure through a plan designed to effect a gradual transfer of ownership from the government to the participating cooperatives.[1] The 1955 amendments[2] authorized three classes of stock in the banks, each with a par value of $100 per share. Class A consists of non-voting, non-dividend shares representing the total pre-1956 government investment; class B is a non-voting, 4% stock replacing the cooperatives' pre-1956 investment; and class C represents the cooperatives' post-1956 investment. Both class B and C stock are issuable only to farmers' cooperative associations, except with approval of the Farm Credit Administration (FCA) and the Directors of the issuing bank. Once *issued*, however, class C stock may be *transferred* to "any person" without restriction, as may class B stock with the permission of the original issuing bank.[3]

Each borrower from a bank for cooperatives is required to own at least one share of class C stock. In addition, a borrower must purchase quarterly an amount of class C

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[1] The plan is outlined in the Report of the House Committee on Agriculture attached to the Bill which embodied the 1955 amendments: "The primary purpose * * * of the bill is to provide a plan under which the banks would be organized on a truly cooperative basis. Borrowing cooperatives would continually make capital contribution to the system so long as they used its credit service. Each year final net savings * * * would be distributed as patronage refunds to borrowing cooperatives in the form of capital, all of which capital would remain in the system until all of the capital stock of the United States had been retired. Each year government capital would be retired in an amount equal to the required stock contributions of and the patronage refunds to the borrowing cooperatives." House Report No. 863 accompanying H. R. 5168.

[2] Act of August 11, 1955, amending 12 U.S.C. § 1134d.

[3] See generally 12 U.S.C. §§ 1134d(a) (1)-(3).

stock equal to 10 to 25 per cent of the interest paid on loans to the bank during that period.[4] Owners of class C stock are entitled to annual "patronage refunds" out of the bank's net earnings, in the form of additional class C stock.[5]

Each year the bank must retire an amount of class A (government) stock equal in value to the class C stock issued during that year.[6] Thus, if the bank issues $1 million in class C stock in 1966, it must have retired at least $1 million of class A stock by the end of the year. Moreover, no class B or class C stock may be retired until the government's investment in class A stock has been completely redeemed.[7] At the argument of the appeal we were informed that this process of tranferring ownership in the banks from the government to the cooperatives, and the complete redemption of the class A stock, is expected to be completed by mid-1967.

After the retirement of all outstanding class A stock, the statute permits the directors of each bank to begin retirement of the oldest outstanding shares of class B and C stock.[8] Under this "first in first out" plan, a revolving fund is created which permits the holder of earlier-issued shares to recoup in cash his initial investment plus any accumulated surplus. Thus, owners of class B and C stock will begin to redeem their shares after the retirement of class A shares has been completed.

When, as in the present case, a bank for cooperatives makes facility loans to a cooperative, it must obtain mortgages on the purchased property.[9] Further protection against default is provided in § 1134d(c) of Title 12, by giving the bank a first lien on all class B and C stock issued to a cooperative, as "additional collateral for any indebtedness of such association to the bank." Although redemption of such stock must normally await retirement of previously-issued shares, the bank's directors are empowered to accelerate retirement or cancellation of stock

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[4] 12 U.S.C. § 1134d(a) (3).
[5] 12 U.S.C. § 1134*l*(a), (b).
[6] 12 U.S.C. § 1134d(a) (1).
[7] 12 U.S.C. § 1134d(a) (2), (3).
[8] *Ibid.*
[9] See 12 U.S.C. § 1134c(a); 12 U.S.C. § 1141e(c) (1); 6 C.F.R. § 70.76.

held by a defaulting borrower, *ibid.*, subject to regulations promulgated by the Farm Credit Administration. These regulations specifically authorize retirement when the borrower has been declared bankrupt or has had a substantial part of its property placed in receivership. 6 C. F. R. § 70.153(a).

II

As noted above, Federation was indebted to the bank in the amount of approximately $162,000, secured by (a) mortgages on the purchased property as well as (b) the statutory lien on class B and class C stock issued to Federation over the years. After the mortgaged property had been sold the bank filed a proof of secured claim listing as security both the mortgages on the property (or the proceeds of the sale) and the liens on the stock. The trustee's answer acknowledged the debt but asked that the bank be required to set off the value of the stock against its claim. The bank moved to dismiss the answer on the ground that, regardless of the value of the stock in its hands, it could not be required to satisfy its claims out of the stock ahead of the mortgages.

The referee conducted a hearing on this motion. At one point, in response to an inquiry by the referee, counsel for the bank conceded that under the bank's accounting system, the book value of class B and C stock was considered equal to its par value, but there was no testimony whatsoever regarding the value of the stock in the hands of the trustee or the general creditors of the bankrupt. At the end of the hearing, the referee announced that he was overruling the bank's motion to dismiss the trustee's answer.

Subsequently, without any further hearings on the question of value, the referee filed written findings of fact and conclusions of law. Treating the proceeding as one under section 57(h) of the Bankruptcy Act for valuation of securities held by a secured creditor, the referee found that in the hands of the bank the stock was worth $113,000, its book value, he further found that

> "[T]he Bank for Cooperatives has control over the purchase and sale of all of its outstanding shares of stock in that it may refuse permission for any person

or corpor ation to purchase said stock; [and] that said stock is not regularly sold on any exchange or over the counter."

The referee therefore ordered the bank to set off the value of the stock against its claim, and ordered Federation to pay the difference between this value ($113,000) and the amount of the claim ($162,000).

In affirming the referee's order, the District Court was apparently influenced by an event which occurred after the referee's decision. The Cotton Producers Association of Atlanta offered to purchase the stock for $50,000—45 per cent of its par value and allocated surplus. The District Court observed that "[n]o other offers have been received and none are likely considering the restrictions on transfer and ownership." It concluded that "[i]f the stock involved here were freely transferable or saleable on the open market, there would be no problem, as it could be sold and the proceeds applied to the debts of the federation," but that under the circumstances, if no offset were allowed, the creditors would be substantially damaged.

III

We agree with the referee that the trustee should be permitted to offset the stock against the bank's claim. The referee, however, ruled that the amount of the offset should be par value plus allocated surplus—a measure with which we do not agree.[10]

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[10] The District Court, accepting the bank's contention that allowance of an offset would result in a premature forced redemption of the stock, felt that an arbitrary refusal by the bank to exercise its statutory power to accelerate retirement of stock held by a bankrupt borrower constituted an abuse of discretion. The court stated that:

"Under the circumstances of this case, the Bank should not refuse to do what it has authority to do when equity and justice demand it. The Bank did not see fit to disclose to the referee its reason, if any, for refusing to credit the stock against the debt, other than its bare conclusion that other borrowing cooperatives would be injured. This is not what is meant by the exercise of discretion."

In its brief in this court, the bank stated that on a number of occasions the Board of Directors considered retiring the stock but declined to do so. This refusal was based on a belief that

"Widespread premature * * * redemption would result in depletion of Bank's capital and impair the marketability of debentures, thereby curtailing, if not defeating Bank's ability to make loans to farmer cooperative associations. It would encourage liquidation of borrow-

Section 57(h) of the Bankruptcy Act establishes a valuation procedure whereby a secured creditor's claim is offset by the value of securities held by him.[11] The bank contends preliminarily that the stock was "held" by the trustee, not the secured creditor, and valuation proceedings were therefore inappropriate. This is a strained reading of the Act. Normally, of course, a secured creditor will have physical possession of the securities since, if they are negotiable, transfer to a bona fide purchaser may cut off his rights. We think, however, that use of the word "held" in section 57(h) was not meant to restrict its applicability to cases where the secured creditor has physical possession of the securities. Rather it appears only to reflect what the draftsmen contemplated as the usual situation. Here the stock is "held" by the bank as security within the design of the Act which gives the bank a lien on the stock, and physical possession of the certificate is of no consequence. There is no contest here over possession and the bank can readily obtain surrender of the certificate. Indeed the trustee is tendering it and the bank need only accept it. The purpose of section 57(h) is to expedite settlement of the bankrupt's estate and, to this end, the section directs valuation and offset of securities which, upon bankruptcy, are equitably owned by the secured creditors. Where, as here, no question arises of competing equities

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ing associations and would give a preference to those liquidating over other stockholders."

These fears seem to us exaggerated in light of the continuing demand for farm credit loans. The suggestion is too fanciful for serious consideration that either redemption or offset would "encourage liquidation" and that cooperatives would embark upon the suicidal course of voluntary bankruptcy in order to recapture their capital investments in the bank. However this may be, we need not substitute our judgment for that of the Board of Directors as to retirement of stock, since we do not order retirement. Nor do we consider offset equivalent to redemption since the bank can reissue the stock at par to other borrowing cooperatives.

[11] § 57(h) of the Act is codified as 11 U.S.C. § 93(h) (1958), and reads as follows:

"The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court."

between the secured creditor and subsequent transferees or other claimants, we hold that section 57(h) is satisfied by a showing that the creditor's lien attaches to specifically identified securities.

The bank vigorously argues that section 1134d(c) of Title 12 makes stock owned by Federation "additional" security for the debt, and being "additional" it may be applied against the debt only after the specific collateral has been exhausted. There is a superficial plausibility to this semantic reasoning but on closer examination we find it unpersuasive. The word "additional" is not so crystal clear that one has no need to look further. The legislative purpose as revealed by the entire context must be considered. Calling the stock additional does not necessarily mean that it is secondary. The stock may well have been denominated "additional" only because specific security for a commodity or facilty loan, though not for an operating capital loan, is required.[12] This characterization, however, does not imperatively fix the order that the bank is bound to follow in satisfying the debt due it. The answer to that question must be sought in the wider perspective afforded by the equitable principles that infuse the administration of the bankruptcy courts.

Application of these principles, particularly the doctrine of marshalling of assets, clearly supports an offset. An apt definition of marshalling was framed by Justice Stone: "The equitable doctrine of marshalling rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." *Sowell v. Federal Reserve Bank*, 268 U. S. 449, 457 (1925). See *Meyer v. United States*, 375 U. S. 233 (1963) (marshalling denied where one fund exempt from creditors' claims under state law); *Merchants' & Mechanics' Bank v. Sewell*, 61 F.2d 814 (5th Cir. 1932). In our circuit marshalling has been employed to prevent a gratuitous sacrifice of one creditor's interests when all interests can be fully protected. See *Textile Banking Co. v. Widener*, 265 F.2d 446 (4th Cir. 1959). In the instant case, the bank's

[12] 6 C.F.R. §§ 70.50, 70.61, 70.76 (1966).

claim is secured by both the mortgages and deeds of trust and the lien on the stock. Satisfaction out of the former would result in a forced sale of the stock at 45 per cent of its par value, while an offset would preserve the value of the stock and fully satisfy the indebtedness without injury to the bank's other shareholders. Under these circumstances marshalling is in order. After full consideration, we think it too far-fetched an assumption that the word "additional" was meant to set aside this deeply rooted doctrine.

We do not overlook the bank's argument emphasizing the importance of preserving the normal chronology of redemption. The offset does not dislocate the plan for we find nothing in the Farm Credit Act which prevents reissuance of the stock to other borrowing cooperatives. Thus, other shareholders, who will be entitled to redemption of their stock before or at the same time as Federation's, are not disadvantaged. Were offset denied, the alternatives open to the trustee would work unneccessary hardship on Federation's general creditors. True, the trustee might retain the stock until its retirement date and then redeem it as par plus allocated surplus. Retirement of class B and class C stock, however, is several years in the future. These shares can be retired in the order of their issuance only after all outstanding class A stock is retired, which, according to the record, will not occur until mid-1967. The record does not disclose when the stock was issued to Federation, nor is it known when all presently outstanding class B and class C stock will be redeemed. Since, therefore, redemption of the trustee's stock may be some years away, holding the stock and delaying the closing of the estate is not a practical alternative. The remaining alternative is for the trustee to sell the stock now and recover what he can. This too is undesirable since only one offer, for 45 per cent of the par value, has been received and, as the District Court noted, others are unlikely. However thin the general market for these shares may be, the continuing stream of borrowers from the bank provides it with a ready market. No practical damage to the bank is to be apprehended from the offset.

However, we agree with the bank that the stock may not be offset at par without a valuation. Stock, as we all

know, may have a value above or below its par. Section 57(h) provides that value may be determined by converting the securities into money, or by agreement, arbitration, compromise or litigation.[13] The bank contends that the hearing before the referee was insufficient "litigation" because no evidence was introduced or testimony taken and the referee relied solely upon a statement by counsel for the bank that the *book* value was not less than par. While the bank's attorney stated in answer to an inquiry from the bench that he did not seriously contest that the stock was worth "at least par," at another point he stressed the inadequacy of the hearing to establish value. To resolve the ambiguity and to give the parties a full and fair opportunity to establish the actual value of the stock, we vacate the order and remand with instructions to the District Court to order a hearing or conduct other appropriate proceedings under section 57(h).

Order vacated and case remanded.

MEMORANDUM ORDER DENYING REHEARING

Filed: November 23, 1966

The bank petitions for a rehearing and modification of our decision of October 4, 1966, in which we directed that the value of the bank's stock held by Federation be offset against Federation's debt to the bank. We remanded the case to the District Court for valuation proceedings under section 57(h) of the Bankruptcy Act.

The petitioner contends that in stating, "[o]wners of class C stock are entitled to annual 'patronage refunds' out of the bank's net earnings * * *," we erroneously overlooked the provision of the statute that such refunds are to be distributed "in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year." The bank argues that as a result of the alleged oversight the valuation which we ordered will be unduly inflated. We do not agree that our language implies

[13] While retirement of the stock would be at its "fair book value not exceeding par," 6 C.F.R. § 70.153 (1966), the procedure under § 57(h) contemplates offset of the actual value of the securities to be determined in the prescribed manner.

what the bank reads into it. Nevertheless, to avoid any possibility of misunderstanding we now add to footnote 5 the following explicit statement:

> It is to be noted that patronage refunds are to be paid "in the proportion that the amount of interest earned on the loans of each borrower bears to the total interest earned on the loans of all borrowers during the fiscal year."

We are not persuaded that the offer of the Cotton Producers Association of 45% of the par value of the stock was reasonable and reflected the true value of the stock, and adhere to our view that a hearing should be held to determine true value.

In support of its petition the bank also argues that we were in error in stating that no practical damage to it is to be apprehended from the offset. The petition asserts that on resale of the stock the bank will be required to retire government owned class A stock of equal value, and that to this extent the bank will be decapitalized. We find nothing in the Act, however, that requires the bank to retire additional class A stock upon *resale*, as distinguished from initial *issuance*, of class C stock. True, Congress, in the 1955 Amendments, set up a plan designed to effect a transfer of the bank's ownership to the participating cooperatives through a gradual retirement of the government's stock investment. But there is no indication that Congress was in such a hurry to accomplish this result that it required the retirement of class A stock upon *resale* of shares of C stock in respect to which a retirement of class A stock has already taken place. Retirement of class A government stock upon the original issuance of the C stock is sufficient to satisfy the Act. Alternatively, the bank may, at its option, merely retain the stock and await its normal retirement date to recoup the par value. While this delay might be said to involve a slight detriment, it is preferable to the course urged by the bank, requiring a forced sale of the stock at a figure which a hearing may show to be a fraction of its real value.

For these reasons, the petition for rehearing is denied and the original opinion, expanded as above indicated with respect to patronage refunds, stands.

HIRAM E. SOBELOFF,
United States Circuit Judge.

LAMBERT S. BOREMAN,
United States Circuit Judge.

A. W. BARKSDALE,
United States District Judge.

MEMORANDUM DECISION OF DISTRICT COURT

After bankruptcy adjudication on February 15, 1963, against Farmers Federation Cooperative, Inc. (hereinafter called Federation), Columbia Bank for Cooperatives (hereinafter called the Bank) filed its proof of secured claim in the amount of $162,155.85. The trustee admitted the claim but was allowed by the referee to credit against it the sum of $113,120.82, representing the value of stock and allocated surplus owned by Federation in the Bank. Bank excepted to the referee's decision and, pursuant to 11 U. S. C. A. Section 11 (a) (10), petitioned this court for review.

Bank is a corporation established under the Farm Credit Act of 1933 and amendments thereto (12 U. S. C. A. Section 1134 *et seq.*).[1] Its purpose is to help meet the credit needs of farmers cooperatives and establish a sound financial system for their operation.

In this case all loans made by Bank to Federation were accrued by various mortgages and deeds of trust on lands, buildings, fixtures, machinery and equipment located in various counties in western North Carolina. In addition, the Bank had a first lien on all stock in the Bank owned by Federation.[2] The stock pledged consists of: (1) 458

[1] There are thirteen such banks in the United States, one in each of the twelve farm credit districts into which the United States is divided and a central bank in Washington, D. C.

[2] Title 12 U.S.C.A. Section 1134(d) (c) provides, in part: "Except as hereinafter provided in the case of an association which is a direct borrower from the central bank, each bank for cooperatives shall have a first lien on all stock in the bank owned by each cooperative association as additional collateral for any indebtedness of such association to the bank."

shares of class B stock in the Bank which had a par value of $45,800.00, (2) 542.7518 shares of class C stock with a par value of $54,275.18, and $13,045.64 of accumulated surplus.

By consent, some of the real property on which the Bank held deeds of trust was sold, and on July 17, 1963, the referee ordered the trustee to deposit in a special account the proceeds from the sale, amounting to $162,000.00, pending further proceedings.

Subsequently, the referee adjudged that the fair book value[3] of both class B and class C stocks was not less than par, and credited against the claim of Bank the sum of $113,120.82 (the combined value of the stock and allocated surplus). On June 5, 1964, the referee directed Federation to surrender its stock together with all rights to accumulated surplus to Bank and directed Bank to credit its value against the indebtedness. The parties were directed to determine the balance due after applying the credit, and the undetermined balance was allowed as a secured claim against the realty fund.

Bank's brief is directed primarily to the contention that the stock holdings and accrued surplus owned by Federation are not "mutual debts" within the meaning of the Bankruptcy Act, affording the right of set-off against the secured claim of Bank.[4] Federation's brief concedes the point. Federation is a stockholder in the Bank; a stockholder is not, in the ordinary sense, a creditor. 18 Am. Jur. (2d) 982, Corporations, Section 488; see *Schneider v. Mingenback,* 139 F. (2d) 87 (10th Cir. 1943); *Brust v. Sturr,* 128 F. Supp. 188 (D. C. N. Y. 1955). But that does not end the matter.

Federation argues that a credit for the stock and accrued surplus should be allowed under 11 U. S. C. A. Section 93 (h) and the marshalling of assets theory.

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[3] Market value apparently is not the test; the statute, 11 U.S.C.A. Section 93(h), uses the word value without qualification. Clearly, the referee, in determining "book value", meant also value of the stock in question.

[4] Title 11 U.S.C.A. Section 108, which controls the right of set-off in bankruptcy, provides: "a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

Title 11 U. S. C. A. Section 93 (h) provides as follows,

> "The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court."

This section is an attempt "to find a reasonable compromise between the basic principle of equality of distribution, on the one hand, and accord due respect for the necessities of legitimate credit transactions, on the other." 3 Collier, Bankruptcy 298, Section 57.20 (14th Ed. 1964). It is applicable in this case.

The Bank, by its mortgages and deeds of trust on various property of Federation, and its first lien on the stock and allocated surplus, was, in effect, twice secured for the same debt. Undoubtedly Bank would have asserted its lien against the stock and allocated surplus had its mortgages and deeds of trust proved of little or no value. As a matter of equity, this should work both ways. The value of the stock and allocated surplus should be credited against Bank's claim since it could have proceeded against that security in satisfaction of its claim.

The referee concluded "that all the equities in this case should require that the claimant make the credit against its claim as prayed for by the trustee pursuant to 11 U. S. C. A. Section 93 (h) . . ."[5]

If the stock involved here were freely transferable or saleable on the open market, there would be no problem, as it could be sold and the proceeds applied to the debts of Federation. But class C stock is not saleable or transferable except to another bank or cooperative. Class B stock

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[5] "The uniform practice in bankruptcy has been to deduct the security from the debt." 3 Collier, Bankruptcy, 298, Section 57.20 (14th Ed. 1964) (citing *New York Trust Co. v. Palmer*, 101 F. (2d) 1 (2d Cir. 1939).

can be sold to such persons as may be approved by Columbia Bank—a provision which has a somewhat chilling effect on saleability.[6]

The Bank is authorized by statute to retire and cancel stock owned by a borrower in partial or total liquidation of the debt where the borrower is in default, dissolution, or liquidation. The Bank argues that to allow Federation to credit the stock against its debt would result in a premature forced redemption of the stock and prejudice other cooperatives whose stock, by reason of prior issuance, enjoys prior redemptive rights. But the Bank made no showing of prejudice or injury to others.

This argument, even conceding that a "premature forced redemption" situation may result, is without merit when considered with the clear statutory provisions for retirement and cancellation of such stock.[7] What the trustee is asking to be done, the Bank, by statute, has **discretionary** authority to do. An arbitrary refusal to act is not exercise of discretion. " 'Discretion' . . . means 'sound discretion', not discretion exercised arbitrarily, but with due regard for that which is right and equitable under the circumstances, and directed by reason and conscience to a just result." *United States v. D'Arganto,* 227 F. Supp. 596 (D. C. Ill. 1964); cf. *Langner v. Green,* 282 U. S. 531, 51 S. Ct. 243, 75 L. Ed. 520 (1931): *Smaldone v. United States,* 211 F.

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[6] Federation has been offered $50,000.00 for *all* of its stock and surplus account by another cooperative. No other offers have been received and none are likely considering the restrictions on transfer and ownership. It is doubtful this offer is still open.

[7] Title 12 U.S.C.A. Section 1134d(c): "In any case where the debt of a borrower is in default, the bank may, in accordance with regulations of the Farm Credit Administration, retire and cancel all or a part of the stock of the defaulting borrower at the fair book value thereof, not exceeding par, in total or partial liquidation of the debt, as the case may be, and, to the extent required, corresponding shares held by a regional bank in the central bank shall be retired."

Title 12 U.S.C.A. Section 1134(1) (d): Public Laws 87-343, 87th Congress (1961) "*Notwithstanding any other provision of this Act,* in the case of liquidaton or dissolution of any present or former borrower from a bank for cooperatives, the bank, may, in accordance with rules and regulations prescribed by the Farm Credit Administration, retire and cancel any capital stock or allocated surplus and contingency reserves or other equity interest, in the bank owned by such borrower at the fair book value thereof, not exceeding par, and, to the extent required, corresponding shares and allocations or other equity interests held by the regional bank in the central bank shall be retired." (Emphasis added.)

(2d) 161 (10th Cir. 1954); *Nitchell-Huron Production Credit Association v. Welsh,* 163 F. Supp. 883 (D.C.S.D. 1958). Under the circumstances of this case, the Bank should not refuse to do what it has authority to do when equity and justice demand it. The Bank did not see fit to disclose to the referee its reason, if any, for refusing to credit the stock against the debt, other than its bare conclusion that other borrowing cooperatives would be injured. This is not what is meant by the exercise of discretion. If the credit is **not** allowed, the resulting pecuniary injury to other creditors of Federation is readily apparent. If credit is allowed, there is no showing of real detriment to Bank or other cooperatives.

Bank argues that under 11 U.S.C.A. Section 93(h),[8] the stock involved would have to be converted into money before its value could be determined, and this the referee did not do. This argument has no merit if it means that the stock must first be sold before its value could be determined.[9]

Title 11 U.S.C.A., Section 93(h) is intended to provide two methods of valuing securities, *In Re Rochester Pad & Wrapper Co.,* 20 F. Supp. 295 (D.C.N.Y. 1937), one by compromise or agreement and another by litigation. A hearing before the referee is sufficient litigation, *In Re Soltmann,* 238 F. 241 (D.C.N.Y.), and the admission of the Bank is sufficient agreement. There is no genuine dispute as to value of the stock. An officer of the Bank said it was worth par. It is of no consequence that he was unsworn.

The referee determined the value of the stock in terms of money after hearing argument on both sides and taking sufficient evidence. This is enough. *In Re Soltmann, supra.*

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[8] Title 11 U. S. C. A. Section 93(h): "The value of securities held by secured creditors shall be determined by converting the same into money according to terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, compromise and litigation, as the Court may direct and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court."

[9] "For practical purposes all valuations under Section 57(h) should be treated alike and no distinction for purposes of reconsideration should be made between conversion into money and any other form of determining the value of a security . . ." 3 Collier, Bankruptcy 325, Section 57.20 (14th Ed. 1964).

After considering all the evidence, it is adjudged that the decision of the referee is supported by substantial evidence, and it is, therefore, affirmed. The petition of the Bank for review is dismissed.

This 14th day of July, 1965.

s/ J. BRAXTON CRAVEN, JR.,
Chief Judge,
United States District Court
for the Western District
of North Carolina.

REFEREE'S FINDINGS OF FACT AND CONCLUSIONS OF LAW

THIS MATTER coming on to be heard and being heard before the undersigned Referee in Bankruptcy on the 5th day of June, 1964, **and upon the admissions and statements of counsel**, the undersigned makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. That the Columbia Bank for Cooperatives is a corporation organized and existing under the laws of the United States with offices at 1401 Hampton Street, Columbia, South Carolina; that said institution came into existence pursuant to the Farm Credit Act of 1933 and the amendments thereto (12 USCA 1134 *et seq.*);

2. That the Farmers Federation Cooperatives, Inc. was a North Carolina corporation and on the 15th day of February, 1963, was adjudicated a bankrupt pursuant to an involuntary petition filed January 29, 1962;

3. That H. Kenneth Lee was duly elected Trustee of the bankrupt estate on the 26th day of March, 1963, at the first meeting of the creditors of said bankrupt;

4. That by appropriate order this matter was referred to the undersigned Referee in bankruptcy who approved the trustee's bond which was duly filed in the office of the Register of Deeds for Buncombe County in Deed Book 879 at page 521;

5. That this matter was heard and is now being determined upon the Proof of secured claim (treated as a Petition) of the Columbia Bank for Cooperatives and the answer to said Proof of secured claim filed by the trustee aforesaid, and the motion to strike filed by the claimant-petitioner;

6. That Farmers Federation Cooperative, Inc., a bankrupt, was on the 15th day of February, 1963, the date of the adjudication of bankruptcy, indebted to Petitioner, Columbia Bank for Cooperatives, in the sum of $162,155.85; that said indebtedness arose as a result of loans by the bank to the bankrupt; that the unpaid principal balance of said loans as of the date of adjudication is $146,371.68; that on said date there was accrued interest of $13,153.47; that the indebtedness is now in default;

7. That the Columbia Bank for Cooperatives holds as security for said loans those security instruments set forth and described in Paragraph 6 of the Proof of secured claim filed herein;

8. That the bankrupt has requested and demanded that there be a partial liquidation of the debt aforesaid; that there be credited against said account the fair value of the following capital stock of the Columbia Bank for Cooperatives owned by the bankrupt, and upon which the bank has a lien as security for the debt:

a. 458 shares of Class B stock with a par and fair value of $45,800;
b. 542.7518 shares of Class C stock with a par and fair value of $54,275.18;
c. allocated surplus to said stock in the amount of $13,945.64, or a total of $113,120.02;

9. That the stock set forth and listed in the next preceding paragraph had a fair book value of at least par on the date of the adjudication, and still has such value;

10. That the Bank for Cooperatives has control over the purchase and sale of all of its outstanding shares of stock in that it may refuse permission for any person or corporation to purchase said stock; that said stock is not regularly sold on any exchange or over the counter;

11. That because borrowers from the Bank for Cooperatives must own stock in the bank in specified percentages in order to secure money, and, inasmuch as the Bank ordinarily sells its own stock to said borrowers, there is little, if any, demand for said stock in the hands of farmers' cooperatives such as the bankrupt;

12. That the stock in said bank is valuable to claimant bank in at least its par value or book value;

13. That the creditors of the bankrupt would be damaged to the extent of the par value of said stock, and its allocated surplus, if the credit as prayed for by the Trustee is not allowed, whereas neither claimant nor creditors would be damaged if the credit is allowed.

That upon the foregoing findings of fact, the Referee drew the following conclusions of law:

CONCLUSIONS OF LAW

1. That the applicable statutes relating to the prayer of the bankrupt for credit as set forth in the Further Answer and Further Defense of the trustee to the Proof of secured claim (Petition) of the Columbia Bank for Cooperatives are as follows:

a. 12 U. S. C. A. 1134 (d) (e) in which a first lien is given to the bank on the stock in question and which provides:

> "in any case where the debt of the borrower is in default, the bank may, in accordance with the regulations of the Farm Credit Administration, retire and cancel all or part of the stock of the defaulting borrower at the fair book value thereof, not exceeding par, in total or partial liquidation of the debt, as the case may be, and, to the extent required, corresponding shares held by the regional bank in the central bank shall be retired."

b. 12 U. S. C. A. 1134 (1) (d) which provides as follows:

> "notwithstanding any other provision of this act, and in the case of liquidation or dissolution of any present or former borrower from a bank of cooperatives, the

bank may, in accordance with rules and regulations prescribed by the Farm Credit Administration, retire and cancel any capital stock or allocated surplus and contingency reserves or other equity interest, in the bank owned by such borrower at the fair book value thereof, not exceeding par, and, to the extent required, corresponding shares and allocations or other equity interest held by the regional bank in the central bank shall be retired."

c. The following provisions of the Bankruptcy Act, 11 U. S. C. A. 93 (h):

"the value of securities held by secured creditors shall be determined by converting the same into money according to terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, compromise, and litigation, as the Court may direct and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance, such determination shall be under the supervision and control of the Court."

2. The Referee concludes that all of the equities in this case should require that the claimant make the credit against its claim as prayed for by the trustee pursuant to 11 U. S. C. A. 93 (h) and that said claimant bank may either hold said stock as treasury stock or may retire the same pursuant to either 12 U. S. C. A. 1134 (d) (e) or 12 U. S. C. A. 1134 (1) (d).

WHEREFORE, it is ordered:

1. That motion to strike of claimant-petitioner is overruled;

2. That the Farmers Federations Cooperative, Inc. surrender the stock set forth in the findings of fact to the Columbia Bank for Cooperatives, Inc. as credit against the indebtedness, at par value of said stock together with all accrued or allocated surplus;

3. That the parties then determine the remaining amount due by the bankrupt to the claimant after application of credits and said remaining amount is here allowed

as a secured claim to be paid out of funds held in escrow by the trustee under previous orders of the Court.

This, the 12 day of August, 1964.

J. HARRY SAMPLE,
Referee in Bankruptcy.

FEDERAL STATUTES

12 U. S. C. 1134d (c) * * * each bank for cooperatives shall have a first lien on all stock in the bank owned by each cooperative association as additional collateral for any indebtedness of such association to the bank.

12 U. S. C. 1134d (3) "* * * each borrower as defined by the Farm Credit Administration for purposes of this sentence, shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the amount of interest payable by it to the bank during the calendar quarter. Payments for such stock shall be made quarterly or when the regular interest payments of the borrower are payable, but the stock shall be issued to the borrower as of the end of each fiscal year in the amount of the payments for stock made by it during the year. * * *"

1134d (a) (1) "* * * The minimum amount of class A stock that shall be retired shall be the equivalent in dollar value of the amount of class C stock issued for that year, * * *"

12 U. S. C. 1134d (a) (3) class C stock, except as approved by the Farm Credit Administration and consented to by the issuing bank, may be issued only to banks for cooperatives and farmers' cooperative associations as defined in section 1141j (a) of this title. Such stock may be issued in fractional shares, shall be issued at its fair book value not exceeding par, as determined by the bank, and no dividends shall be paid on it. * * * each borrower as defined by the Farm Credit Administration for purposes of this sentence, shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the

amount of interest payable by it to the bank during the calendar quarter. * * *

After retirement of all class A stock, class C stock also may be retired at par by calling the oldest outstanding class C stock, but class C stock that was issued for a fiscal year period shall not be called for retirement until all class B stock that was issued during or prior to that fiscal year has been called for retirement.

12 U.S.C. 1134l (a) Each bank for cooperatives, at the end of each fiscal year, shall determine the amount of its net savings after paying or providing for all operating expenses (including reasonable valuation reserves and losses in excess of any such applicable reserves) and shall apply such savings as follows: (1) To the restoration of the amount of the impairment, if any, of capital stock, as determined by its board of directors; (2) 25 per centum of any remaining savings shall be used to create and maintain a surplus account; (3) if said bank shall have outstanding capital stock held by the United States during the whole or any part of the fiscal year, it shall next pay to the United States as a franchise tax, a sum equal to 25 per centum of its net savings then remaining, not exceeding, however, a rate of return on such Government capital calculated at a rate equal to the computed average annual rate of interest on all public issues of public debt obligations of the United States issued during the fiscal year ending next before such tax is due, as certified to the Farm Credit Administration by the Secretary of the Treasury; (4) reasonable contingency reserves may be established; (5) dividends on class B stock may be declared as provided in section 1134d (a) (2) of this title; and (6) any remaining net savings shall be distributed as patronage refunds as provided in subsection (b) of this section: * * *

12 U.S.C. 1134l (b) The patronage refunds of each regional bank for cooperatives shall be paid in class C stock to borrowers, as defined by the Farm Credit Administration for the purposes of this subsection, during the fiscal year for which the refunds are declared. * * * All patronage refunds shall be paid in the proportion that the amount of interest earned on the loans of each borrower

bears to the total interest earned on the loans of all borrowers during the fiscal year. * * *

12 U. S. C. 1134l (d) Notwithstanding any other provision of this Act, in the case of liquidation or dissolution of any present or former borrower from a bank for cooperatives, the bank, may, in accordance with rules and regulations prescribed by the Farm Credit Administration, retire and cancel any capital stock or allocated surplus and contingency reserves or other equity interest, in the bank owned by such borrower at the fair book value thereof, not exceeding par, and, to the extent required, corresponding shares and allocations or other equity interests held by the regional bank in the central bank shall be retired. As amended Oct. 3, 1961, Pub. L. 87-343, § 2(3), 75 Stat. 758; Aug. 31, 1964, Pub. L. 88-528, 78 Stat. 736.

12 U. S. C. 1134 (m) * * * "The debentures shall be secured by collateral which shall be at least equal to the amount of debentures outstanding and which shall consist of cash, direct obligations of the United States, or notes or other obligations discounted or purchased or representing loans made under sections 1134 c and 1134 j of this title." * * *

11 U. S. C. 93 (h) The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court.

11 U. S. C. 108 (a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.

REGULATIONS

12 CFR § 670.142 Capital stock ownership required with respect to loans conforming to the Farm Credit Act of 1955; district banks.

Each borrower from a bank for cooperatives shall be required to own at the time the loan is made at least one share of class C stock. The purchase price of such stock may be retained out of the loan. In addition, each borrower as defined by the Farm Credit Administration for purposes of this sentence, shall be required to invest quarterly in class C stock an amount equal to not less than 10 nor more than 25 per centum, as prescribed by the board of directors of the bank with the approval of the Farm Credit Administration, of the amount of interest payable by it to the bank during the calendar quarter. Payments for such stock shall be made quarterly or when the regular interest payments of the borrower are payable, but the stock shall be issued to the borrower as of the end of each fiscal year in the amount of the payments for stock made by it during the year. (Section 42 (a) (3), Farm Credit Act of 1933, as amended; 12 U. S. C. 1134d.)

12 CFR § 670.153 Cancellation and retirement of stock of defaulting borrowers; authorized cancellation and retirement.

In any case where the debt of a borrower to a bank for cooperatives is in default such bank may retire and cancel all or part of the stock of the bank owned by the defaulting borrower (except class B stock issued with the provision that the bank shall have no statutory lien thereon which has not been specially pledged to the bank by the holder as additional collateral for the holder's indebtedness to the bank) at the fair book value thereof (not exceeding par), in total or partial liquidation of the debt, if:

(a) The borrower has been declared bankrupt;

(b) The borrower has had a substantial part of its property placed in the hands of a receiver;

(c) The borrower has ceased operations, regardless of whether its charter has been surrendered; or

(d) In the judgment of the bank, the indebtedness of the borrower to the bank is uncollectible.

12 CFR § 670.162 Allocations of surplus and contingency reserves; district banks.

Net savings of a district bank for cooperatives which are placed in the surplus account or set aside as contingency reserves at the end of any fiscal year, as provided in section 36(a) of the Farm Credit Act of 1933, as amended (12 U. S. C. 1134l), shall be allocated to all farmers' cooperative associations which during any part of the fiscal year were primarily liable to the bank for the repayment of loans made by the bank pursuant to section 7 of the Agricultural Marketing Act, as amended (12 U. S. C. 1141e): *Provided,* That, if the bylaws of a bank so provide, no allocation shall be made to any association which files with the bank prior to the beginning of a fiscal year a written refusal to accept such allocations for said year. Allocations shall be made in the proportion that the amount of interest accrued on the loans of each borrower bears to the total interest accrued on the loans of all borrowers during the fiscal year, and shall be recorded on the books of the bank as allocations for such fiscal year.

12 CFR § 670.164 Same; lien on allocated surplus.

Each bank for cooperatives shall have a first lien on all the amounts allocated to each borrower as additional collateral for any indebtedness of such borrower to the bank.

12 CFR § 670.165 Same; cancellation and retirement of allocations of surplus of defaulting borrowers.

In any case where the debt of the borrower is in default and the bank is authorized under § 670.153 to cancel and retire stock in the bank and apply the proceeds on the indebtedness, the bank may retire and cancel all or part of the allocations to the defaulting borrower in total or partial liquidation of the debt, as the case may be, but such allocations shall not be so retired and canceled until all stock of the bank owned by the borrower has been retired and canceled. All allocations of surplus to a defaulting borrower shall be retired and canceled before any allocations of

contingency reserves to such borrower are retired and canceled.

12 CFR § 670.165a Cancellation and retirement of stock and other equities of borrower in liquidation or dissolution.

In the case of liquidation or dissolution of any present or former borrower from a bank for cooperatives, the bank may retire and cancel any capital stock or allocated surplus or contingency reserves or other equity interest in the bank owned by such borrower at the fair book value thereof, not exceeding par, as hereinafter indicated.

(a) The bank has reasonable assurance that the liquidation or dissolution is or soon will be completed and that the business of the borrower is not being continued in circumstances in which it would be appropriate and feasible for the successor to acquire and hold the interests of its predecessor in the bank.

(b) The retirement of stock and other equities of any such borrower would not unduly affect the financial position of the bank.

(c) Any such retirement shall be subject to authorization as follows:

(1) Whenever the total amount of equities to be retired in any one case is $5,000 or less the Executive or Loan Committee of the bank may approve the retirement when authorized to do so by the Board of Directors;

(2) Whenever the total amount of equities to be retired in any one case is in excess of $5,000 but does not exceed $25,000, retirement may be made only upon prior approval of the Board of Directors; and

(3) Whenever the total amount of equities to be retired in any one case is in excess of $25,000, retirement may be made only upon prior approval of the Board of Directors, subject to approval of the Farm Credit Administration.

(d) At the same time, corresponding shares of stock which the regional bank was required to purchase in the Central Bank shall also be retired.

(e) A report of any retirements made hereunder showing the name of the association and the amount of separate

equities retired for each shall be forwarded to the Director of Cooperative Bank Service at the end of each quarter.

(Sec. 6, 47 Stat. 14, as amended; 12 U. S. C. 665. Supplements sec. 36, 48 Stat. 263, as amended by sec. 2(3), 75 Stat. 758; 12 U. S. C. 1134l (d))

REPORT NO. 863 OF HOUSE COMMITTEE ON AGRICULTURE ACCOMPANYING H. R. 5168

"Under present law, the required capital stock purchases by borrowing cooperatives will not furnish sufficient capital funds to permit the banks to operate on a sound basis and meet the credit needs of farmers' cooperatives. As presently organized, the use of government capital is essential to the continued operation of the system.

"The primary purpose of Title I of the bill is to provide a plan under which the banks would be organized on a truly cooperative basis. Borrowing cooperatives would continually make capital contribution to the system so long as they used its credit service. Each year final net savings (after taxes, dividends, reserves and surplus requirements) would be distributed as patronage refunds to borrowing cooperatives in the form of capital, **all of which capital would remain in the system until all of the capital stock of the United States had been retired** (emphasis added). Each year government capital would be retired in an amount equal to the required stock contributions of and the patronage refunds to the borrowing cooperative."